Australian Government

Australian Accounting Standards Board

Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600

Dr Andreas Barckow
Chairman
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf, London E14 4HD
UNITED KINGDOM
(submitted via the IASB website)

27 September 2023

Dear Dr Barckow,

AASB submission on IASB Request for Information on Post-implementation Review of the Impairment Requirements of IFRS 9 *Financial Instruments*

The Australian Accounting Standards Board (AASB) welcomes the opportunity to provide comments on the International Accounting Standards Board (IASB) Request for Information on Post-implementation Review of the impairment requirements of IFRS 9 *Financial Instruments* issued in May 2023.

In formulating these comments, the views of Australian stakeholders were sought and considered. This consultation included the following outreach activities to gather views from stakeholders:

(a) AASB Financial Instruments Project Advisory Panel

(b) AASB User Advisory Committee

(c) other targeted consultations with financial statement preparers, auditors and professional bodies.

The AASB acknowledges the efforts of the IASB to assess whether the effects of applying the impairment requirements in IFRS 9 on the stakeholders are as intended when the standard was developed.

Overall, we agree that the impairment requirements of IFRS 9 are working as intended and provide more timely information about expected credit losses than IAS 39. However, the feedback from our stakeholders indicated that the impairment requirements did not enhance the transparency and comparability of financial statements as much as expected. The feedback we received indicates some diversity in the measurement of credit losses as well as information disclosed, in particular, around model inputs and post-model adjustments. Therefore, we recommend:

(a) further clarifying some aspects of measurement of credit losses in illustrative examples to enhance consistency of application;

(b) developing additional disclosure requirements to enable users of financial reports to understand the quantitative impact of assumptions and other model inputs and post-model adjustments on the loss provision; and

(c) developing additional guidance on substantial modifications of contractual cash flows of financial assets.

In addition, we suggest that the IASB reconsider the appropriateness of the general model approach for intra-group balances.

The detailed recommendations and responses to the specific questions for respondents are in the Appendix to this letter. If you have any questions regarding this letter, don't hesitate to contact myself or Helena Simkova, Director (hsimkova@aasb.gov.au).

Yours sincerely,

Dr Keith Kendall
Chair – AASB

APPENDIX

AASB responses to questions raised in the IASB Request for Information on Post-implementation Review of the impairment requirements of IFRS 9 *Financial Instruments*

Question 1—Impairment
Do the impairment requirements in IFRS 9 result in: **(a) more timely recognition of credit losses compared to IAS 39 and address the complexity caused by having multiple impairment models for financial instruments? Why or why not?** **(b) an entity providing useful information to users of financial statements about the effect of credit risk on the amount, timing and uncertainty of future cash flows? Why or why not?** Please provide information about the effects of the changes to the impairment requirements introduced by IFRS 9, including the ongoing costs and benefits of preparing, auditing, enforcing or using information about financial instruments. This question aims to help the IASB understand respondents' overall views and experiences relating to the IFRS 9 impairment requirements. Sections 2–9 seek more detailed information on specific requirements.

The AASB agrees that IFRS 9 does, in most cases, result in:

(d) more timely recognition of credit losses compared to IAS 39 and address the complexity caused by having multiple impairment models for financial instruments, and

(e) to some extent, an entity providing useful information to users of financial statements about the effect of credit risk on the amount, timing, and uncertainty of future cash flows.

However, we encourage the IASB to review several areas where the lack of guidance or the level of judgement involved may result in a diversity of the application of the IFRS 9 impairment requirements and, therefore, may reduce the comparability of financial statements. Specific requests for further improvements to IFRS 9 through potentially additional standard setting, application guidance, or illustrative examples are explained in Questions 2 – 10.

Question 2—The general approach to recognising expected credit losses
(a) Are there fundamental questions (fatal flaws) about the general approach? If yes, what are those fundamental questions? Please explain whether requiring entities to recognise at least 12-month expected credit losses throughout the life of the instrument and lifetime expected credit losses if there has been a significant increase in credit risk achieves the IASB's objective of entities providing useful information about changes in credit risk and resulting economic losses. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the general approach. **(b) Are the costs of applying the general approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?** If, in your view, the ongoing costs of applying the general approach to particular financial instruments are significantly greater than expected or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment for those instruments.

The AASB confirms that, in general, there are no fundamental questions (fatal flaws) about the general approach. However, the AASB understands that the relevant objective of the general approach was to distinguish between initial estimates of credit losses and subsequent changes and to provide users with useful information about changes in credit risk. Whether such an objective was fully achieved is uncertain due to diversity in modelling and overlay adjustments, which reduce the transparency and comparability of the information disclosed. Our comments on modelling and overlays are included in Question 4.

Stakeholders' feedback indicated that the general model does not apply well to intercompany loans as the credit loss may also depend on factors like the parent entity's willingness to reimburse the lending entity, which increases the effort needed to apply the impairment requirements. As a result, the usefulness of the credit loss provisions may not be commensurate to the effort required for their calculation. In view of some, it would be helpful to have a different approach to record intercompany loan credit losses.

The AASB suggests that the IASB reconsiders the appropriateness of the current model for intra-group balances and whether an alternative approach would result in better information provided to the users of financial statements while reducing the preparers' costs. We acknowledge such an approach would be an exception to the general approach to expected credit losses.

Question 3—Determining significant increases in credit risk
(a) Are there fundamental questions (fatal flaws) about the assessment of significant increases in credit risk? If yes, what are those fundamental questions? Please explain whether the principle-based approach of assessing significant increases in credit risk achieves the IASB's objective of recognising lifetime expected credit losses on all financial instruments for which there has been a significant increase in credit risk since initial recognition. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the assessment of significant increases in credit risk. **(b) Can the assessment of significant increases in credit risk be applied consistently? Why or why not?** Please explain whether the requirements provide an adequate basis for entities to apply the assessment consistently to all financial instruments within the scope of impairment requirements in IFRS 9. If diversity in application exists for particular financial instruments or fact patterns, please explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. If you have identified diversity in application of the assessment, please provide your suggestions for resolving that diversity. In responding to (a) and (b), please include information about **applying judgement** in determining significant increases in credit risk (see Spotlight 3).

The AASB confirms that there are no fundamental questions (fatal flaws) about the assessment of significant increases in credit risk (SICR). However, some stakeholders noted the inconsistent application of requirements when assessing SICR. In addition, the feedback also indicated that whilst the expected credit loss (ECL) models are based on the entities' risk management model and internal policy, in practice, many entities in the non-financial services sector do not have an explicit internal policy addressing the credit risk, or they do not clearly define the default event (despite the existence of rebuttable presumption in IFRS 9). Hence, for example, situations when the debtor has the ability to meet its debt obligation (i.e., no indication of SICR) but not the intention may not be appropriately reflected in the ECL.

To reduce the diversity in practice, the AASB suggests that the IASB considers developing additional guidance. Further targeted outreach may be required to identify the areas or scenarios that need additional guidance. The guidance should also address situations when the counterparty has the ability but not the intention to meet its obligations.

The AASB also noted that during the pandemic, the IASB issued guidance to assist with SICR assessment.[1] As our stakeholders found this guidance helpful, we recommend removing the references to the pandemic and incorporating the explanation into the Standard as application guidance.

1 IASB, IFRS 9 and Covid-19 – Accounting for expected credit losses

Question 4—Measuring expected credit losses

(a) Are there fundamental questions (fatal flaws) about requirements for measuring expected credit losses? If yes, what are those fundamental questions?

Please explain whether the requirements for measuring expected credit losses achieve the IASB's objective of providing users of financial statements with useful information about the amount, timing and uncertainty of an entity's future cash flows. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the measurement requirements.

(b) Can the measurement requirements be applied consistently? Why or why not?

Please explain whether the requirements provide an adequate basis for entities to measure expected credit losses consistently for all financial instruments within the scope of impairment requirements in IFRS 9. If diversity in application exists for particular financial instruments or fact patterns, please explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. If you have identified diversity in application of the requirements, please provide your suggestions for resolving that diversity. In responding to (a) and (b), please include information about **forward-looking scenarios** (see Spotlight 4.1), **post-model adjustments or management overlays** (see Spotlight 4.2) and **off-balance-sheet exposures** (see Spotlight 4.3), as relevant

The feedback from stakeholders implied that there is a lack of consistency:

(a) in the modelling and assumptions used, the number of scenarios and overlays (or sometimes called post-model adjustments) used to estimate provisions; and

(b) in the quality of information disclosed and its level of detail.

This inconsistency makes it difficult to understand the drivers of the provision movements. Therefore, the AASB is concerned about the lack of comparability of ECLs in financial statements.

Our users expressed concern that the current model allows for reverse engineering, and entities may amend the assumptions and probabilities used in the model to achieve a desired outcome. In addition, information disclosed about overlays is inconsistent even within the same industry, for example, the banking industry. This results in reduced comparability of provisions across otherwise similar bank institutions. We observed that the users are interested in understanding:

(a) the quality of the portfolio and how it moves through the three stages, including the drivers for the movements rather than just the value allocated to each stage; and

(b) the extent of a change in ECL driven by changes in the underlying assets (e.g., the value of current period ECL if the model used prior period assumptions).

To enhance the transparency of the ECL, the IASB should consider the need for additional disclosures enabling the users of financial reports to understand the quantitative impact of assumptions and post-model adjustments on the loss provision. The required disclosure could be a sensitivity analysis or a value of the prior year ECL calculated using current period inputs (or vice versa). The practicality of such disclosures and the costs relative to the expected benefits should be considered. Further research in this area might be required.

Whilst the AASB acknowledges that it would be difficult to mandate exact guidance on the number of scenarios and model inputs used, we suggest that the IASB provides an illustrative example that could provide more application guidance and help the entities with an assessment of what reasonable number of scenarios constitutes.

Question 5—Simplified approach for trade receivables, contract assets and lease receivables
(a) Are there fundamental questions (fatal flaws) about the simplified approach? If yes, what are those fundamental questions? Does applying the simplified approach achieve the IASB's objective of reducing the costs and complexities of applying IFRS 9 impairment requirements to trade receivables, contract assets and lease receivables? If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the simplified approach. **(b) Are the costs of applying the simplified approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?** If, in your view, the ongoing costs of applying the simplified approach are significantly greater than expected, or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment.

The AASB confirms that, in general, there are no fundamental questions (fatal flaws) about the simplified approach.

Several stakeholders thought that the requirement to incorporate forward-looking information is too complex for some smaller corporate entities, even when using the simplified approach. Those stakeholders noted a need for additional guidance on calculating the ECL for new customers or markets in the absence of historical information. The AASB suggests that the IASB considers the need for educational material on the application of the standard (including the incorporation of forward-looking factors) by smaller corporate entities. In addition, we suggest including within the standard the explanation in BCE.164, which explains that in some cases, entities with little historical information would draw their estimates from internal reports and statistics (which may, for example, have been generated when deciding whether to launch a new product), information that they have about similar products or from peer group experience for comparable financial instruments.

The stakeholders' feedback also noted that some entities do not define and disclose what the default event is (also noted in Question 3 above). The AASB suggests that the issued educational guidance should include an explanation of the relevance of the requirements in IAS 1 paragraph 117 on disclosure of material accounting policies.

Question 6—Purchased or originated credit-impaired financial assets
Can the requirements in IFRS 9 for purchased or originated credit-impaired financial assets be applied consistently? Why or why not? Please explain whether the requirements can be applied consistently to these types of financial assets and lead to accounting outcomes that faithfully reflect the underlying economic substance of these transactions. If there are specific application questions about these requirements, please describe the fact pattern and: (a) explain how the IFRS 9 requirements are applied; (b) explain the effects of applying the requirements (for example, the quantitative effect on an entity's financial statements or an operational effect); (c) explain how pervasive the fact pattern is; and (d) support your feedback with evidence.

Our stakeholders' feedback implied that the interaction between ECL, restructuring, and modifications is challenging, especially for purchased or originated credit-impaired (POCI) assets. In particular, determining whether changes to the cash flows of the financial instrument are substantial requires the use of management judgement (as the AASB noted in its response to the Request for Information on Post-implementation review of the classification and measurement requirements of IFRS 9). This has an impact on potentially recognising a new loan and assessing whether the new loan is POCI, which may result in different expected credit loss provisions. The AASB recommends that the IASB considers issuing additional guidance and illustrative examples in respect of the treatment of POCI.

Question 7—Application of the impairment requirements in IFRS 9 with other requirements
Is it clear how to apply the impairment requirements in IFRS 9 with other requirements in IFRS 9 or with the requirements in other IFRS Accounting Standards? If not, why not? If there are specific questions about how to apply the impairment requirements alongside other requirements, please explain what causes the ambiguity and how that ambiguity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. Please describe the fact pattern and: (a) indicate the requirements in IFRS 9 or in other IFRS Accounting Standards to which your comments relate; (b) explain the effects of applying the requirements (for example, the quantitative effect on an entity's financial statements or an operational effect); (c) explain how pervasive the fact pattern is; and (d) support your feedback with evidence. In responding to this question, please include information about matters described in this section of the document.

Similar to comments raised regarding POCI in the question above, stakeholders raised an issue relating to the modification of contractual cash flows in response to the interaction of ECL requirements with other IFRS 9 requirements or other standards. Assessing whether the modification is substantial or not is often challenging and has an impact on the ECL calculation.

The AASB notes that the standard does not provide clear guidance on what substantial changes to the cash flow of financial instruments represent. We recommend the IASB consider developing guidance, including indicators of substantial modification of contractual cash flow and interaction of the modification requirements with ECL requirements.

Question 8—Transition
Were the costs of applying the transition requirements and auditing and enforcing their application significantly greater than expected? Were the benefits to users significantly lower than expected? Please explain whether the combination of the relief from restating comparative information and the requirement for transition disclosures achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements. Please explain any unexpected effects or challenges preparers of financial statements faced applying the impairment requirements retrospectively. How were those challenges overcome?

The AASB concluded that the transition requirements worked as intended.

Question 9—Credit risk disclosures

(a) Are there fundamental questions (fatal flaws) about the disclosure requirements in IFRS 7 for credit risk? If yes, what are those fundamental questions?

Please explain whether the combination of disclosure objectives and minimum disclosure requirements for credit risk achieves an appropriate balance between users of financial statements receiving:

(i) comparable information—that is, the same requirements apply to all entities so that users receive comparable information about the risks to which entities are exposed; and

(ii) relevant information—that is, the disclosures provided depend on the extent of an entity's use of financial instruments and the extent to which it assumes associated risks.

If an appropriate balance is not achieved, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the disclosure requirements.

(b) Are the costs of applying these disclosure requirements and auditing and enforcing their application significantly greater than expected? Are the benefits to users significantly lower than expected?

If, in your view, the ongoing costs of providing specific credit risk disclosures are significantly greater than expected or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment for those disclosures. Please provide your suggestions for resolving the matter you have identified.

If, in your view, the IASB should add specific disclosure requirements for credit risk, please describe those requirements and explain how they will provide useful information to users of financial statements.

Please also explain whether entities' credit risk disclosures are compatible with digital reporting, specifically whether users of financial statements can effectively extract, compare and analyse credit risk information digitally.

The AASB confirms that there are no fundamental questions (fatal flaws) about the disclosure requirements in IFRS 7 for credit risk. However, we have identified the need for further specific disclosures in Question 4 above.

Question 10—Other matters
(a) Are there any further matters that you think the IASB should examine as part of the post-implementation review of the impairment requirements in IFRS 9? If yes, what are those matters and why should they be examined? Please explain why those matters should be considered in the context of this post-implementation review and the pervasiveness of any matter raised. Please provide examples and supporting evidence. **(b) Do you have any feedback on the understandability and accessibility of the impairment requirements in IFRS 9 that the IASB could consider in developing its future IFRS Accounting Standards?**

No additional issues were raised by our stakeholders.